CHAPTER 8

GAINS AND LOSSES ON THE DISPOSITION OF CAPITAL PROPERTY—CAPITAL GAINS

Review Questions

1. A capital gain or capital loss is the gain or loss realized from the disposition of capital property. What is meant by the term "capital property," and how is it different from other property?

2. Is it necessary for property to provide a long-term benefit to its owners in order for the gain or loss on sale to be considered a capital gain or capital loss?

3. When it is unclear whether a gain or loss on a sale of property is of a capital nature, what factors are considered when judging the transaction?

4. An investor acquired a residential high-rise apartment as an investment. The property has now been owned for 11 years and annually has provided reasonable net rental income. This net rental income has been reinvested in other types of properties as well as in improvements to the apartment building. The owner is considering either selling the property to another investor or dividing the property into separate condominium units that will be marketed to existing tenants and to the public. Explain how a gain on sale will be treated for tax purposes under each alternative.

5. Distinguish among financial property, personal-use property, and listed personal property. Which of these three categories is (are) subject to capital gains treatment?

6. Distinguish between a capital gain and a taxable capital gain and between a capital loss and an allowable capital loss.

7. Explain why the tax treatment of capital gains is often described as preferential, while the treatment of capital losses is often considered unfair.

8. "A capital gain or loss can be recognized for tax purposes only when capital property is sold." Is this statement true? Explain.

9. A corporation acquires a licence that permits it to manufacture a patented product for 10 years in exchange for the payment of a royalty. Describe the tax treatment that will occur if the taxpayer sells the licence for more than its cost or less than its cost to another party before the 10-year term expires. Would the tax treatment be the same if the licence had an unlimited life?

10. What advantage can a taxpayer achieve by incurring a capital gain on property and permitting the purchaser to pay for the property over a number of years?

11. Because of the tax treatment, an investment in shares of a small business corporation may present less risk than an investment in shares of a public corporation. Explain why.

12. What difference does it make when the sole shareholder of a corporation provides $10,000 of additional capital to the corporation as a loan (shareholder's loan), rather than in return for additional share capital?

13. "The sale of a warehouse building used by a taxpayer to operate a business can result in a capital gain but not a capital loss." Is this statement true? Explain.

14. Explain how the tax treatment of personal-use property deviates from the normal tax treatment of capital property.

15. When an investor buys some shares of a corporation at one price and later buys more shares of the same corporation at another price, how does the investor determine the cost for tax purposes when some, but not all, of the shares are eventually sold?

16. When an investor acquires a commodity or a contract to purchase a commodity in the future, what type of property does that investor own? Can a gain or loss on the sale of commodities or futures contracts result in a capital gain or loss?

17. An investment in capital property that appreciates in value at 10% per year is more valuable than an investment in capital property that provides an annual return, such as interest, of 10%. Explain why.

Solutions to Review Questions

R8-1. Property acquired for providing the owner with a long-term or enduring benefit is classified as capital property. Property acquired for reselling it at a profit is classified as inventory, and any gain or loss realized is business income (loss).

R8-2. It is not necessary for property to actually provide a long-term benefit to its owner, but rather the intended purpose of acquisition must be to provide such a benefit. Whether or not property actually achieves its intended purpose is governed by future events, which may or may not be controllable by the owner.

R8-3. A taxpayer's intended purpose in acquiring a property is not always clear, and yet it is necessary for the tax authorities to assess such transactions. The following factors are considered when judging intended purpose:

- Period of ownership.
- Nature of the transaction, including the point of purchase, use of the property during the ownership period, and the reasons for and the method of the disposition.
- Number and frequency of transactions.
- Relation of the transaction to the taxpayer's business.

By examining all of the above factors together, a course of conduct may be apparent which supports the intended purpose.

R8-4. *Sale of entire property to an investor* - based on the limited information, it would appear that the selling price in excess of the original cost would be a capital gain. The property was held for a long period and generated regular annual benefits. As there is no indication of a history of buying and selling such properties, the intended purpose of acquisition as a capital property appears to be supported.

Sale of property by separate condominium units - the selling process under this alternative requires significant effort by the vendor and therefore becomes a factor in assessing the original intention. Three possible results may occur. Because the method of sale is similar to that used by developers, it provides evidence that the property was acquired for the purpose of resale and any gain is business income. Another possibility is that the owner changed intention at some point. For example, once it was decided to dispose of the property, a condo sale was initiated to enhance the proceeds. Because the use of the property changed, it would be appropriate to expect a capital gain up to the value before the condo conversion, and business income on the additional profit. However, neither of these may be appropriate if, for example, a number of tenants requested a condo conversion after they become aware the property was for sale. Such circumstances may nullify the influence of the conversion allowing full capital gain treatment.

R8-5. Personal-use property is capital property owned by a taxpayer and used primarily for personal use and enjoyment (car, house, boat) [ITA 54 definition *personal-use property*]. Listed personal property is specific capital property identified as jewelry, rare folios, manuscripts or books, prints, paintings and similar works of art, stamps and coins [ITA 54 definition *listed personal property*]. Financial property is capital property that provides a benefit from financial returns. All three categories of capital property are subject to capital gains treatment.

R8-6. A capital gain is the amount by which the proceeds of disposition from capital property exceeds the adjusted cost base and the costs of disposition [ITA 40(1)(a)(i)]. A capital loss is the amount by which the adjusted cost base plus the costs of disposition exceeds the proceeds of disposition [ITA 40(1)(b)]. A taxable capital gain and allowable capital loss is one-half of the capital gain or capital loss determined above [ITA 38(a) & (b)].

R8-7. The tax treatment of capital gains is considered preferential to other types of income because only one-half of the gain is taxable. The treatment of capital losses may be considered unfair because they can only be applied to reduce taxable income to the extent of capital gains earned from the sale of capital properties [ITA 3(b)], whereas other types of losses can be applied against any source of income.

R8-8. The statement is not true. A capital gain or loss is recognized when a disposition of the property occurs. While in most cases a disposition is caused by a sale, there are a number of situations where a deemed disposition occurs for tax purposes even though a sale or exchange has not taken place. A deemed disposition at fair market value occurs when:

- Property is transferred by way of a gift [ITA 69(1)(b)(ii)].
- The use of property changes from personal use to business or investment use or vice versa [ITA 45(1)].
- When a taxpayer ceases to be a resident of Canada [ITA 128.1].
- A taxpayer dies [ITA 70(5-10)].

In addition, loans receivable are deemed to be disposed of when the debt is considered uncollectible [ITA 50(1)(a)]. Similarly, a deemed disposition of shares occurs when the corporation is legally bankrupt or when the business has ceased and the corporation is insolvent (and an election is made under subsection 50(1) [ITA 50(1)(b)].

R8-9. The license is capital property that also qualifies as depreciable property under class 14 (due to its limited legal life). If the property is sold for a price in excess of the original cost, one-half of the excess is a taxable capital gain [ITA 38(a)]. In addition, to the extent that capital cost allowance has been claimed on the original cost, a recapture of capital cost allowance will occur which is considered business income [ITA 13(1)]. If the license is sold at less than the original cost, a capital loss will NOT occur [ITA 39(1)(b)(i)]. Instead, either a recapture of capital cost allowance or a terminal loss may occur depending on whether the selling price is greater than or less than the undepreciated capital cost of the class 14 depreciable property [ITA 13(1); 20(16)]. A capital loss cannot occur on depreciable property [ITA 39(1)(b)(i)].

If the license were for an unlimited life, the tax treatment on the sale would be the same. The license would be class 14.1 depreciable property as opposed to class 14.

R8-10. With delayed payment of proceeds, the taxpayer can use the capital gain reserve provisions, which delay the recognition of a portion of the taxable capital gain within defined limits. This has two possible advantages.

- The taxpayer can earn interest (from the purchaser) on amounts that would otherwise have been paid out as tax in the year of sale. Therefore, returns on the investment of the proceeds are enhanced.
- By spreading out the recognition of income over several years, the rate of tax may be lower in

some or all of those future years [ITA 40(1)(a)(iii), 40(2)(a)].

R8-11. If an investment in shares of a small business corporation results in a loss, that loss would qualify as an allowable business investment loss (1/2 of the capital loss) [ITA 38(c) & 39(1)(c)]. The loss can be offset against any other source of income if the taxpayer has other sources of income (e.g., from business, employment, property or other sources) [ITA 3 (d)] and will result in an immediate reduction of taxes otherwise payable.

On the other hand, a loss from the sale of shares of a public corporation can only be offset against other capital gains, which restricts the use of the loss [ITA 3(b)]. Therefore, it is more difficult to obtain a tax reduction from the loss on public corporation shares. Hence, such investments, all else being equal, present greater risk.

R8-12. In both circumstances, the owner provides the same amount of capital to the corporation. However, the ultimate tax treatment to the owner may be different for each method. If the corporation has financial difficulty and the owner's capital is in jeopardy, the loan method results in a better tax treatment. A capital loss on the loan is deemed to occur when the debt is considered to be uncollectible, whereas a loss on the share capital will occur only when the shares are sold or the corporation becomes legally bankrupt or has ceased operations and is insolvent [ITA 50(1)]. Therefore, capitalization by debt provides an opportunity for a faster recognition of a loss for tax purposes. If the owner can use such a loss sooner rather than later, the ultimate loss measured in cash flow terms may be diminished; or the tax savings achieved earlier can be advanced to the corporation to reduce its financial problems and reduce the risk of a business failure.

R8-13. Yes, the statement is true. The building is depreciable capital property, which can result in a capital gain if the selling price is greater than the cost. However, as depreciable property, no capital loss can occur [ITA 39(1)(b)(i)]. Proceeds below the original cost affect only the capital cost allowance class, which the building is part of. See the solution to question 9 above.

R8-14. The tax treatment of personal-use property deviates from the normal treatment of capital property because any loss incurred on personal-use property is deemed to be zero [ITA 40(2)(g)(iii)]. Therefore, gains on personal use property are taxable but losses from such property cannot be used even to reduce capital gains from other personal use properties.

R8-15. The acquisition of shares of the same class of a corporation is considered identical properties for tax purposes. The adjusted cost base of each identical property acquired (in this case, each share) is the weighted average cost of all the identical properties up to the point of the sale of some or all of those properties [ITA 47(1)].

R8-16. The acquisition of commodities can only provide a benefit to the owner as a result of their resale. Therefore, such properties are always acquired for reselling at a profit. The property is inventory and any gain or loss is either business income or a business loss. However, by administrative policy, a taxpayer may elect to treat commodity transactions as capital property resulting in capital gains or capital losses if that method is used consistently. This option is not available to taxpayers who are associated with the commodity business or who take commodity positions as part of their normal business or trade.

R8-17. An investment in capital property providing an annual growth rate of 10% will be taxed only when the property is sold, and only one-half of the gain is taxable. The investment, therefore, compounds annually at the pre-tax rate of 10% and is taxed only when realized.

An investment in capital property that earns 10% annual interest is taxable annually as it is earned, and the full amount is taxable. Therefore, an investment return of 10% can only compound at its after-tax rate. For example, if the investor is subject to a 40% tax rate, the 10% return will compound when reinvested at 6% annually compared to 10% under the capital gain option. Therefore, over time, holding appreciating property provides an increased rate of return because of the timing and the amount of the tax cost (1/2 is taxable).

Key Concept Questions

QUESTION ONE

Colin Fitzgerald sold capital property in 2022 for $600,000 and incurred $24,000 in selling costs. The property had an adjusted cost base of $176,000. Colin received $150,000 at the time of the sale and a note for the balance. The note is to be repaid over nine years in equal instalments of $50,000, commencing in 2023.

Determine the minimum taxable capital gain to be reported by Colin in 2022, 2023, and 2024.

CPA Competency 6.2.2 Capital gains reserve. Income tax reference: ITA 40(1)(iii).

QUESTION TWO

Which of the following corporations are Small business corporations (SBC) as defined in Section 248 of the *Income Tax* Act?

a) A Ltd. is a public corporation with 95% of the fair market value of its assets used in an active business carried on primarily in Canada.

b) B Ltd. is a Canadian-controlled private corporation with 60% of the fair market value of its assets used in an active business carried on in Canada. The remaining 40% is an investment in long-term bonds.

c) C Ltd. is a Canadian-controlled private corporation with 80% of the fair market value of its assets used primarily in an active business carried on in Canada. The remaining 20% is an investment in term deposits.

d) D Ltd. is a Canadian-controlled private corporation that owns one asset. The asset is a warehouse that is used by a related corporation in carrying on its active business in Canada.

CPA Competency 6.2.2 Small business corporations. Income tax reference: ITA 248.

QUESTION THREE

In 2019, Ross Delacruz loaned $10,000 to a small business corporation. The loan bears interest at 6% per annum and is due on demand. Ross did not receive his interest in 2021 although he reported it on his 2021 tax return. By December 31, 2022, it was established that the loan was bad and that Ross would not be receiving the $10,000 principal or the interest for 2021 or 2022.

Determine the 2022 tax consequences for Ross.

CPA Competency 6.2.2 Business investment loss. Income tax reference: ITA 20(1)(p), 39(1)(c), 50(1).

QUESTION FOUR

Determine the loss to be reported for tax purposes for each of the following dispositions.

a) An individual sold a Class 10 depreciable asset for $10,000. The asset cost $25,000 when it was purchased. The UCC of Class 10 was $16,000 before the sale. After the sale, there are no assets left in Class 10.

b) An individual sold their home for $180,000. The home cost $210,000 when it was purchased.

c) An individual transferred shares of X Ltd. worth $18,000 to their RRSP. They paid $25,000 for the shares when they purchased them a few years ago.

d) An individual sold 100 shares of N Ltd. for $10,000 on December 15, 2022. The ACB of the 100 shares was $17,000. On January 5, 2023, the value of N Ltd. declined further and they repurchased 40 shares of N Ltd. for $3,200.

e) On June 30, 2022, Old Inc. sold its investment in shares of Blue Ltd. (1% of Blue's outstanding shares) to New Inc. for $30,000. The shares had been acquired 4 years previous for $40,000. Carla Petrov is the controlling shareholder of both Old Inc. and New Inc. In February 2023, New Inc. sold the shares of Blue Ltd. for $46,000. The taxation year-end for New Inc. and Old Inc. is December 31.

CPA Competency 6.2.2 & 6.3.2 Capital losses denied. Income tax reference: ITA 20(16), 39(1)(b)(i), 40(2)(g), 40(3.3), (3.4), 53(1)(f), 54.

QUESTION FIVE

In the current year, Valerie Khan disposed of the following personal items:

	Proceeds	***Cost***
Car	$1,500	$6,000
Jewellery	200	1,200
Oil painting	2,000	800
Antique table	1,800	900

Valerie has an unclaimed capital loss on listed personal property of $3,000 that was incurred five years ago.

Determine Valerie's net taxable capital gains to be reported for the current year.

CPA Competency 6.3.2 Personal-use and listed personal property. Income tax reference: ITA 3(b), 40(2)(g)(iii), 41(1), (2), 46(1), 54.

QUESTION SIX

Michael Market traded in shares of Blue Inc. during the current year. His transactions were as follows:

	No. of shares	***Cost per share***	***Total***
January 15 Purchased	200	$45	$9,000
March 7 Purchased	300	$22	$6,600
November 21 Sold	(100)	$45	$4,500

Determine the ACB of the shares sold. Michael did not own any shares of Blue Inc. before January 15.

CPA Competency 6.2.2 Identical property. Income tax reference: ITA 47(1).

QUESTION SEVEN

Early last year, Hazel Lovell purchased 100 units of Sky mutual fund for $12 per unit. She received a T3 from the fund for last year showing the following distributions from the fund, all of which were reinvested in her account resulting in the purchase of three additional units:

• Actual amount of eligible dividends	$30.00
• Taxable amount of eligible dividends	$41.40
• Capital gains	$10.00
• Interest	$ 8.00

On January 4 of the current year, Hazel sold 50 of her mutual fund units for $900.

Determine the taxable capital gain to be reported by Hazel in the current year.

CPA Competency 6.2.2 Identical property – Mutual funds. Income tax reference: ITA 47(1).

QUESTION EIGHT

Jane Herbert acquired a house in 2018 for $300,000. In 2020, she acquired a cottage for $150,000. She lived in the house in the winter and in the cottage in the summer. In 2022 she sold both properties. She received $400,000 for the house and $250,000 for the cottage.

Determine the minimum taxable capital gain to be reported by Jane on the sale of the two properties.

CPA Competency 6.3.2 Principal residence. Income tax reference: ITA 40(2)(b).

QUESTION NINE

Richard Ahmad is employed by a Canadian oil company. In Year 3, he was transferred from Toronto to Calgary. He rented his home to a tenant while he was in Calgary (Year 3 to Year 9). In the middle of Year 9, he moved back into his home in Toronto. In Year 12, he sold his Toronto home. The value of the home at relevant dates was as follows:

Year 1	(purchase price)	$250,000
Year 3	commenced renting the home	$320,000
Year 9	moved back into the home	$450,000
Year 12	sold the home	$490,000

Determine the minimum taxable capital gain(s) to be recognized by Richard — (a) without a Subsection 45(2) election, and (b) with a Subsection 45(2) election.

CPA Competency 6.2.2 & 6.3.2 Change in use & Principal residence. Income tax reference: ITA 40(2)(b), 41(1), 45(2), 54, 54.1.

QUESTION TEN

On March 20, 2022, Stephen Fielding sold his common shares of Salt Ltd., an eligible small business corporation, for $800,000. His shares had an ACB of $100,000. On October 1, 2022, Stephen purchased newly issued common shares of Pepper Ltd., also an eligible small business corporation. He paid $400,000 for the shares of Pepper Ltd.

a) Determine the maximum amount of capital gain on the sale of the Salt Ltd. shares that can be deferred.

b) What will be the ACB of the Pepper Ltd. shares, assuming Stephen elects to defer the maximum capital gain possible, on the Salt Ltd. shares?

Deferral for eligible small business shares. Income tax reference: ITA 44.1.

QUESTION ELEVEN

On March 20, 2022, Growth Ltd. moved its head office into its newly acquired building in Toronto. The new building cost $800,000 (land - $300,000; building - $500,000). The former office building, in downtown Toronto, was sold in January, 2021 for $650,000 (land - $200,000; building - $450,000). Growth Ltd. operated from leased space in the meantime. The former office building cost $400,000 (land - $150,000; building - $250,000). Class 1 had an UCC balance of $220,000 at the end of 2020. Growth Ltd. has a December 31 year-end.

Describe the tax consequences of the move, including the capital cost and UCC for the new building, assuming Growth Ltd. wishes to minimize taxes.

CPA Competency 6.2.2 Replacement property. Income tax reference: ITA 13(4); 44(1), (5).

QUESTION TWELVE

In the current year, James Craig earned the following income:

• Employment income		$80,000
• Property income		2,000
• Gains:		
• Shares of Corporation X	$12,000	
• Personal-use property	7,000	
• Listed personal property	1,600	20,600
• Losses:		
• Shares of Corporation Y	(15,000)	
• Shares of small business corporation	(4,000)	
• Listed personal property	(300)	(19,300)
		$83,300

Determine net income in accordance with the aggregating formula in Section 3 of the ITA. Assume *Other deductions* total $1,000.

CPA Competency 6.3.2 Net income. Income tax reference: ITA 3.

QUESTION THIRTEEN

On June 30, 2022, Janelle Walker moved from a small town in Scotland to Toronto, Ontario. She became a resident of Canada for tax purposes on that date. At the time of the move, she owned the following assets:

Asset	Cost	June 30, 2022 Value
Home in Scotland	$400,000	$ 600,000
Rental property in Scotland	300,000	480,000
Rental property in Toronto	500,000	1,200,000
Public company shares	200,000	325,000

Determine the adjusted cost base for each of the assets for Canadian income tax purposes.

CPA Competency 6.5.2 Deemed acquisition rules on becoming resident. Income tax reference: ITA 128.1(1)(b),(c).

QUESTION FOURTEEN

On October 24, 2022, Anika Agarwal moved to a rural area in India from Ottawa, Ontario. She became a non-resident of Canada for tax purposes on that date. At the time of the move, she owned the following assets:

Asset
Home in Ottawa
Rental property in Ottawa
Public company shares
Private company shares, inherited on her father's death last year
Registered retirement savings plan (RRSP)
Tax-free savings account (TFSA)

(a) Which of the assets are deemed disposed at market value on emigrating from Canada?
(b) Are there elections available to minimize the tax burden on emigrating?
(c) How would your answer to (a) change if Anika had immigrated to Canada within the last five years?

CPA Competency 6.5.2 Deemed disposition rules on becoming non-resident; Availability of elections. Income tax reference: ITA 128.1(4)(b),(d), 128.1(10), 220(4.5).

Solutions to Key Concept Questions

KC 8-1

[ITA: 40(1)(iii) – Capital gains reserve]

The minimum taxable capital gain to be reported is $50,000 in 2022, $30,000 in 2023 and $40,000 in 2024.

(2022)	Proceeds	$600,000
	ACB	(176,000)
	Selling costs	(24,000)
	Gain	400,000
	Capital gains reserve – lesser of:	
	• $450,000/600,000 x $400,000 = $300,000	
	• 4/5 x $400,000 = $320,000	(300,000)
	Capital gain	$100,000
	Taxable capital gain	$ 50,000
(2023)	Gain (2022 reserve)	$300,000
	Capital gains reserve – lesser of:	
	• $400,000/600,000 x $400,000 = $266,667	
	• 3/5 x $400,000 = $240,000	(240,000)
	Capital gain	$ 60,000
	Taxable capital gain	$ 30,000
(2024)	Gain (2023 reserve)	$240,000
	Capital gains reserve – lesser of:	
	• $350,000/600,000 x $400,000 = $233,333	
	• 2/5 x $400,000 = $160,000	(160,000)
	Capital gain	$ 80,000
	Taxable capital gain	$ 40,000

KC 8-2

[ITA: 248(1) definition of *Small Business Corporation*]

A small business corporation (SBC) is defined in ITA 248(1) as a Canadian-controlled private corporation (CCPC) with all or substantially all (90% or more) of the fair market value of its assets attributable to one of the following:

- Used principally in an active business carried on primarily in Canada by the particular corporation or by a corporation related to it,
- Shares or debt of one or more connected SBCs (greater than 10% ownership), or
- A combination of the two.

a) A Ltd. cannot be an SBC because it is not a CCPC.

b) B Ltd. cannot be an SBC because less than 90% of the fair market value of its assets is qualifying assets.

c) Whether C Ltd. is an SBC depends on whether the term deposits are a short-term investment of excess cash that will be needed in the business cycle and therefore an asset used in the active business. If it is, then C Ltd. is an SBC. If the term deposits are excess cash that will not be needed in the business, then C Ltd. is not an SBC because less than 90% of the fair market value of its assets is qualifying assets.

d) D Ltd. is an SBC. It is a CCPC with all of the fair market value of its assets being assets used in an active business carried on in Canada by a related corporation.

KC 8-3

[ITA: 20(1)(p); 39(1)(c); 50(1) – ABIL]

The interest income included in Ross's 2021 income has become a bad debt in 2022. Therefore, in 2022 Ross can claim a bad debt deduction [ITA 20(1)(p)] in computing his property income for the year.

The $10,000 loan has become a bad debt in 2022. Ross can make an election under ITA 50(1) to be deemed to dispose of the loan at the end of 2022 for proceeds of Nil and to have reacquired it on the first day of 2023 for a cost of Nil. If Ross makes the election, he will have an allowable business investment loss (ABIL) of $5,000 in 2022. The ABIL is deductible against all sources of income.

Loan to small business corporation (SBC):

Proceeds	$ 0
ACB	(10,000)
Business investment loss	$(10,000)
Allowable business investment loss	$ (5,000)

This solution assumes Ross has never claimed a capital gains deduction. See chapter 10.

KC 8-4

[ITA: 20(16), 39(1)(b)(i), 40(2)(g), 40(3.3),(3.4), 53(1)(f), 54 – Capital losses denied]

a) There is a terminal loss of $6,000 on the disposal of the Class 10 asset [ITA 20(16)]. Capital losses are not allowed on depreciable assets [ITA 39(1)(b)(i)]. The selling price of $10,000 is $15,000 less than the cost of $25,000; this loss is fully recognized for tax purposes as follows:

CCA claimed in previous year	$ 9,000
Terminal loss	6,000
	$15,000

b) The home is a personal-use property (PUP) as defined in ITA 54. Therefore, the loss is denied for tax purposes [ITA 40(2)(g)(iii)].

c) The $7,000 loss on the shares transferred to the RRSP is denied for tax purposes. If the shares had been transferred to a TFSA, the loss would be denied as well [ITA 40(2)(g)(iv)].

d) The individual has an allowable capital loss (ACL) of $2,100 in 2022.

Proceeds	$10,000
ACB	(17,000)
Loss	(7,000)
Superficial loss – 40/100 x $7,000	2,800
Capital loss	$ (4,200)
Allowable capital loss	$ (2,100)

The loss on 40 of the shares ($2,800) is a superficial loss because the individual acquired identical shares within the 30-day period following the sale [ITA 54]. The superficial loss is denied and is added to the ACB of the 40 shares reacquired [ITA 53(1)(f)]. Therefore, the ACB of the 40 shares acquired is $6,000 (cost $3,200 + superficial loss $2,800).

e) Old Inc. has an allowable capital loss (ACL) of $5,000 but not until 2023.

2022 Sale:	Proceeds	$30,000
	ACB	(40,000)
	Loss	(10,000)
	Denied Loss	10,000
	Capital loss	$ 0

Old Inc. is denied the capital loss in 2022 since the loss was incurred on the sale of a capital property to an affiliated person [ITA 40(3.3)]. Old Inc. and New Inc. are affiliated persons, since they are both controlled by Carla [ITA 251.1 (1)(c)]. The denied loss is retained by Old Inc. and cannot be recognized until such time as the affiliated person sells the asset (and it remains sold for 30 days) or the asset is deemed sold under the deemed disposition rules (i.e., on death) [ITA 40(3.4)].

Old Inc. can recognize the capital loss in 2023 when New Inc. sells the shares of Blue Ltd. The allowable capital loss is $5,000.

New Ltd. will have a capital gain of $16,000 on the sale (Proceeds $46,000 – ACB $30,000).

KC 8-5

[ITA: 3(b), 40(2)(g)(iii), 41(1), (2), 46(1), 54 Definitions LPP & PUP]

	LPP	PUP	
Car ($1,500 - $6,000)		$ 0	(Note 1)
Jewellery ($1,000 - $1,200)	$ (200)		(Note 2)
Oil painting ($2,000 - $1,000)	1,000		(Note 2)
Antique table ($1,800 - $1,000)		800	(Note 2)
	800	$ 800	
LPP loss carried forward	(800)		(Note 3)
Net gain – LPP	$ Nil		
Taxable net gain – LPP	$ Nil		

ITA 3(b):	Taxable capital gains – other than LPP ($800 x ½) =	$400
	Taxable net gain – LPP	0
	Net taxable capital gains for the year	$400

Note 1: PUP losses are denied [ITA 40(2)(g)(iii)].

Note 2: Where the cost or the proceeds of PUP or LPP are less than $1,000, the amount is bumped to $1,000 [ITA 46(1)].

Note 3: LPP losses can be carried back 3 years and forward 7 and deducted in computing net LPP gains for the year [ITA 41(2)].

KC 8-6

[ITA: 47(1) – Identical property]

Blue Inc. shares:

Proceeds	$4,500
ACB	(3,120)
Capital gain	$1,380
Taxable capital gain	$ 690

The adjusted cost base of each identical property acquired is the weighted average cost of all the identical properties acquired up to the point of sale [ITA 47(1)]. When Michael sold the 100 shares, he owned 500 shares with a total cost of $15,600 or $31.20 per share. Thus, the ACB of the 100 shares sold is $3,120 ($31.20 x 100 shares).

KC 8-7

[ITA: 47(1) – Identical properties - Mutual funds]

Proceeds	$900
ACB $12.12 x 50 units	(606)
Capital gain	$294
Taxable capital gain	$147

The ACB of the mutual fund units is the weighted average cost of all the identical units acquired up to the point of sale [ITA 47(1)].

100 units x $12 =	$1,200
3 units	48 *
103	$1,248

ACB per unit $12.12 ($1,248/103 units)

* Distribution reinvested $48 (actual amount of dividends $30 + capital gains $10 + interest $8)

KC 8-8

[ITA: 40(2)(b) – Principal residence exemption]

The minimum taxable capital gain is $10,000. Since the gain per year owned on the cottage is higher than on the house, designation years should be allocated to the cottage to completely exempt the gain before allocating any years to the house.

	House	Cottage
Proceeds	$400,000	$250,000
ACB	(300,000)	(150,000)
Gain	100,000	100,000
Principal residence exemption		
(1+3)/5 x 100,000	(80,000)	
(1+2)/3 x 100,000		(100,000)
Capital gain	$ 20,000	Nil
Taxable capital gain	$ 10,000	$ Nil
Gain per year	$20,000	$33,333

Years designated:

- Cottage - 2021 and 2022
- House - 2018, 2019 and 2020

If the cottage is designated for two years, with the 1+ rule, the gain on the cottage is exempt. This leaves three years to be allocated to the house. The sale of both properties must be reported on Schedule 3 *Capital Gains (or Losses)*, on Jane's tax return for 2022 and the years designated are reported on Form T2091 (IND) *Designation of Property as a Principal Residence*.

KC 8-9

[ITA: 40(2)(b), 41(1), 45(2), 54, 54.1 – Principal residence exemption and change in use]

Part (a) No subsection 45(2) election

In year 3 when Richard begins earning rental income, he changes the use of the property from personal use to income earning. When this occurs, Richard is deemed to dispose of the home for its fair market value and to immediately reacquire it at a cost equal to that fair market value. The same occurs in year 9 when Richard changes the use of the property back to personal use [ITA 45(1)].

	Year 3	***Year 9***	***Year 12***
Proceeds	$320,000	$450,000	$490,000
ACB	(250,000)	(320,000)	(450,000)
Gain	70,000	130,000	40,000
Principal residence exemption -			
• (1+2)/3 x $70,000	(70,000)		
Years designated – 1 & 2			
• Not a principal residence		(0)	
• (1+3)/4 x $40,000			
Years designated – 9 to 11			(40,000)
Capital gain	$ 0	$130,000	$ 0
Taxable capital gain	$ 0	$ 65,000	$ 0

Part (b) Subsection 45(2) election

If Richard elects under subsection 45(2) not to recognize the change in use in Year 3 then the property remains a personal-use property for tax purposes even though he is earning rental income from it. When he moves back into the home in Year 9, there is no change in use since the property has remained a personal-use property.

The definition of *principal residence* includes a property that the taxpayer does not ordinarily inhabit but that has a subsection 45(2) election on it. Such a property can be designated as a principal residence for a maximum of 4 years [ITA 54]. However, where the taxpayer is not living in the home due to an employment transfer, the 4 years is extended indefinitely, if the employee moves back into the home within 1 year after ceasing to be employed by that employer [ITA 54.1].

Richard can designate the Toronto home as his principal residence for years 1, 2, 3, 9, 10, 11 and 12 because he ordinarily inhabited the Toronto home at some time during those years. He can designate the Toronto home for years 4, 5, 6, 7 and 8, if the property has a subsection 45(2) election on it during those years, because he is not living in the home due to an employment transfer and he moves back into the home within the time requirement.

	Year 12
Proceeds	$490,000
ACB	(250,000)
Gain	240,000
Principal residence exemption - (1+11)/12 x $240,000	(240,000)
Years designated – 1 to 11	
Capital gain	$ 0
Taxable capital gain	$ 0

Thus, in this case, Richard is better to make the subsection 45(2) election.

KC 8-10

[ITA: 44.1 – Eligible small business deferral]

Section 44.1 provides a deferral of the gain on disposal of an investment in a small business when an investment in another small business is made. To qualify the share must be newly issued common shares and must be owned by the individual for at least 185 days. Once the individual sells the shares, a new investment must be made in another eligible small business within a specified period. The new shares must be acquired within 120 days after the end of the year in which the old shares are sold.

Part (a):
The sale of the Salt Ltd. shares results in capital gain of $700,000 ($800,000 - $100,000). Since 50% of the proceeds from the sale of the Salt Ltd. shares ($400,000/$800,000 = 50%) are reinvested in Pepper Ltd., an eligible small business corporation, 50% of the capital gain on the Salt Ltd. shares can be deferred. Thus, Stephen can defer $350,000 of the capital gain.

Part (b):
The deferred portion of the capital gain ($350,000) reduces the ACB of the new investment in Pepper Ltd. shares from $400,000 to $50,000 ($400,000 - $350,000).

KC 8-11

[ITA: 13(4); 44(1), (5) – Voluntary disposition]

In 2021, Growth Ltd.'s income for tax purposes increased by $155,000 because of the disposal of the Toronto office building (recapture $30,000 + taxable capital gains $125,000).

Class 1:

	UCC balance, beginning of year		$220,000
(2021)	Purchases	$ 0	
	Disposals (limited to original cost)	(250,000)	(250,000)
			(30,000)
	Recapture of CCA		30,000
	UCC balance, end of year		$ 0

	Land	Building
Proceeds	$200,000	$450,000
ACB	(150,000)	(250,000)
Capital gain	$ 50,000	$200,000
Taxable capital gain	$ 25,000	$100,000

When the disposition is voluntary and recapture occurs, the taxpayer is permitted to defer recognition of the recapture if a replacement property with a similar business use is acquired within 12 months after the taxation year in which the disposition occurs [ITA 13(4)]. Similarly, the capital gain can be deferred, provided the same criteria are met [ITA 44(1)].

The new office building was acquired by March 20, 2022, which is within the 12-month time limit. Growth Ltd. should attach a letter to its 2022 tax return indicating that elections under ITA 13(4) & ITA 44(1) are being made to defer the 2021 recapture and taxable capital gains. The letter should include amended calculations for 2021 as follows:

2021 Amended:

UCC balance, beginning of year		$220,000
Purchases		0
Disposals (limited to original cost)	$(250,000)	
Reduced by the lesser of:		
• Normal recapture $30,000		
• Cost of new building $500,000	30,000	(220,000)
Recapture of CCA		$ 0

Capital gains – lesser of	Land	Building
1) normal capital gain	$50,000	$200,000
2) proceeds for the former asset in excess of amount spent for the replacement asset		
- land ($200,000 - $300,000)	$0	
- building ($450,000 - $500,000)		$0
Capital gain	$ 0	$ 0

Since all of the proceeds for both the land and the building were reinvested in the replacement property, the entire capital gain is deferred. If Growth Ltd had downsized (spent less for the new property than the proceeds received for the former property), a capital gain equal to the proceeds not invested would have been recognized.

The tax value of the new premises is reduced by the income deferred on the former premises. The ACB for the replacement property will be reduced by the deferred capital gain [ITA 44(1)(f)]. The ACB and UCC for the replacement property acquired are as follows:

	Land	Building
Cost	$300,000	$500,000
Less capital gain deferred [ITA 44(1)(f)]	(50,000)	(200,000)
ACB of replacement property	$250,000	300,000
Recapture deferred [ITA 13(4)(d)]		(30,000)
UCC of replacement building		$270,000

KC 8-12

[ITA: 3 – Aggregating formula]

3(a)	Employment income		$80,000	
	Property income		2,000	$82,000
3(b)	Taxable capital gains:			
	Shares of Corp X ($12,000 x ½)	$6,000		
	Personal-use property ($7,000 x ½)	3,500	$ 9,500	
	Taxable net gain – LPP ($1,600 - $300) x ½		650	
			10,150	
	Allowable capital losses ($15,000 x ½)		(7,500)	2,650
				84,650
3(c)	Other deductions			(1,000)
				83,650
3(d)	ABIL on SBC shares ($4,000 x ½)			(2,000)
	Net income for tax purposes			$81,650

KC 8-13

[ITA: 128.1(1)(b),(c) – Deemed acquisition rules on becoming resident]

Asset	Cost	June 30, 2022 Value	ACB
Home in Scotland	$400,000	$ 600,000	$600,000
Rental property in Scotland	300,000	480,000	480,000
Rental property in Toronto	500,000	1,200,000	**500,000**
Public company shares	200,000	325,000	325,000

Assets owned by taxpayers immigrating to Canada are deemed acquired at market value immediately before immigrating. Therefore, immigrants are taxable in Canada on gains accruing after immigration, only. The exception is *taxable Canadian property,* which includes real estate located in Canada.

Non-residents are taxable in Canada on gains on disposal of taxable Canadian property. Therefore, this type of property does not get a new cost base on immigration.

KC 8-14

[ITA: 128.1(4)(b),(d), 128.1(10), 220(4.5) – Deemed disposition rules on becoming non-resident & available elections]

(a) On emigrating from Canada, Anika was deemed to have disposed of the public company shares and the private company shares.

(b) An election is available to defer payment of the tax related to the deemed dispositions on departure. If the election is made, the tax is paid later, without interest, when the assets are sold.

As well, Anika can elect to have a deemed disposition on her Ottawa home and/or her rental property. The election increases the cost base of the asset, which will reduce the gain subject to tax in Canada on sale of the real estate in the future. The election will also enable Anika to use tax losses, if available.

(c) If Anika had immigrated to Canada within the last five years, she would not be deemed to have disposed of the shares inherited on her father's death. Assets owned when a taxpayer became resident, or inherited while resident, are not deemed disposed on emigration, if the taxpayer was not resident in Canada for more than 60 months during the 10-year period before emigration.